economic trends

April 2013

Alberta leads provinces in economic growth

For the second straight year, Alberta posted the largest increase in real GDP by industry. Alberta's growth was fairly broad-based, with oil and gas extraction and construction posting particularly strong gains. In this month's InFocus, household debt servicing ratios are compared across provinces.

Global Economy

International Monetary Fund (IMF) lowers global growth forecast

In its April World Economic Outlook, the IMF cut its outlook for global economic growth this year. Growth is now expected to be 3.3%, 0.2 percentage points lower than in January. This is the fourth time since April 2012 that the IMF has downgraded its global growth forecast. The Eurozone crisis and a lack of resolution on the US fiscal situation continue to hold back the global outlook. However, recent policy actions in both the US and Europe have reduced short term risks.

Bank of Canada expects slow growth

The Bank of Canada downgraded its forecast for 2013 Canadian economic growth by 0.5 percentage points to 1.5% in the April Monetary Policy Report. The revision is concentrated over the first three quarters of 2013, in part due to the continuing challenges in the resource sector that began in the second half of 2012. The outlook for inflation has also been revised down, with inflation not returning to the Bank's 2% target until 2015. With slowing growth and a tepid outlook for inflation, the Bank maintained its overnight lending rate at 1%, where it has been since September 2010.

Natural gas prices climb

Spot prices for natural gas have trended upwards after hitting a low of 1.95 US$/MMBtu in April 2012. Henry Hub natural gas rose to 3.82 US$/MMBtu in March 2013. Current Henry Hub spot prices are at 4.39 US$/MMBtu, one of the highest levels in the last twenty-one months. Falling storage levels have contributed to higher prices, dipping below their five-year average for the first time since October 2011. The unexpectedly cold and long North American winter has helped reduce storage levels.

Key Indicators — All indicators seasonally adjusted unless otherwise indicated

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	March	2,168	+1.7%
Unemployment Rate	March	4.8%	-0.4 p.p.
CPI Inflation	March	1.2%	-0.5 p.p.
Retail Sales	February	$6.0B	+7.4%
Housing Starts (annualized)	March	34,918	-1.4%
Rigs Drilling (unadjusted)	April	115	-18.2%
Manufacturing Shipments	February	$6.4B	1.4%
Exports (unadjusted)	February	$8.0B	2.0%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

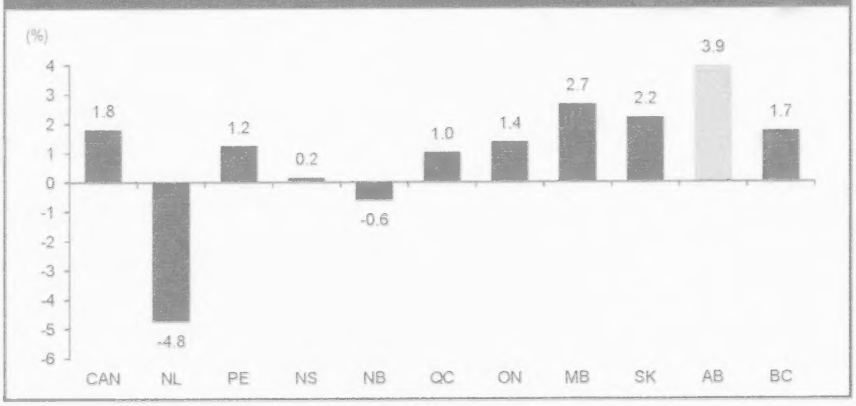
Alberta Business Sector

Alberta records strong GDP growth for the third straight year

Alberta's real GDP by industry expanded by 3.9% in 2012, leading all provinces and more than doubling the national increase of 1.8% (Chart 1). Alberta's growth was closely in line with the *Budget 2012* forecast and the *Budget 2013* estimate of 3.8% growth.

A major growth driver was the oil and gas extraction industry, where GDP grew 6.1% on increased production from the oil sands. This gain was partially offset by a decline in energy related support services (-16.6%), as weaker gas activity weighed on rigs drilling. Gains in fabricated metals, machinery and wood products propelled the manufacturing sector (+5.3%), while the construction sector (+7.7%) benefited from an increase in residential and engineering construction activity. Service-producing industries expanded 3.7%, led by finance and insurance, real estate and rental and leasing, and professional, scientific and technical services.

Chart 1: 2012 Real GDP growth by industry



Source: Statistics Canada

Manufacturing shipments move higher

Manufacturing shipments reached their highest level in fifteen months in February. Recent increases have been fuelled in large part by food, petroleum & coal, and wood products. In particular, the wood products industry has seen shipments soar by an average rate of over 30% year-over-year for the last 12 months. Wood product shipments have more than doubled from their recession lows in mid-2009, aided by a rebound in US housing activity and higher lumber prices.

Construction activity to post further gains

Building permits signal a further expansion in construction activity in Alberta. In the first two months of 2013, permits have jumped 22.6% over the same time last year. Growth has been led by non-residential permits (+33.7%), particularly in the commercial sector. Residential permits (up 15.2% year to date) also point to continued strength in the new housing market.

Alberta Household Sector

Labour market remains healthy despite March job decline

Alberta lost 11,300 jobs last month, erasing most of the gains in the first two months of the year. However, on a year-to-date basis, Alberta continues to post solid job growth. Employment in the province is up 43,600 (+2.0%) in the first quarter of 2013 compared with the same time last year, with new jobs roughly split between the public and private sector.

With the job loss in March, the unemployment rate increased to its highest level since April 2012, hitting 4.8% after sitting at 4.5% for three months. Alberta's unemployment rate remains the second lowest in Canada after Saskatchewan. A strong inflow of migrants to the province has added to the labour force and prevented the unemployment rate from falling, despite continued job growth. Rising in-migration has also helped fill new job openings. Alberta's job vacancy rate, the number of job openings for every position required, has been trending lower in recent months.

Housing activity maintains momentum

Supported by strong in-migration, Alberta's new housing market continues to buck the national slowing trend. New housing starts have remained above 30,000 (seasonally adjusted at annual rate, SAAR) since last August, coming in at 34,918 in March. Starts are up 8.1% year-to-date compared with a 15.2% national decline. New home price gains have been accelerating slightly, particularly in the Calgary market (Chart 2). The resale housing market also remains strong; the sales-to-new-listings ratio has been above 0.60 since last June, signaling a sellers' market.

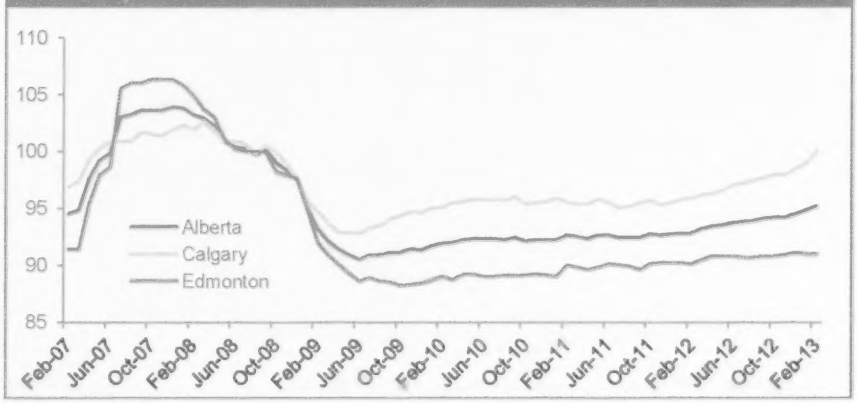
Retail sales growth accelerates

A healthy labour market and strong population growth is supporting continued gains in consumer spending. Spending at retail stores gained strength in February, recording the strongest year-over-year increase (7.4%) in six months (Chart 3). Sales at motor vehicle dealers have been particularly strong in 2013, rising 18% in the first two months compared with last year and accounting for over 60% of Alberta's year-to-date retail sales growth.

Inflation edges up, but outpaced by earnings growth

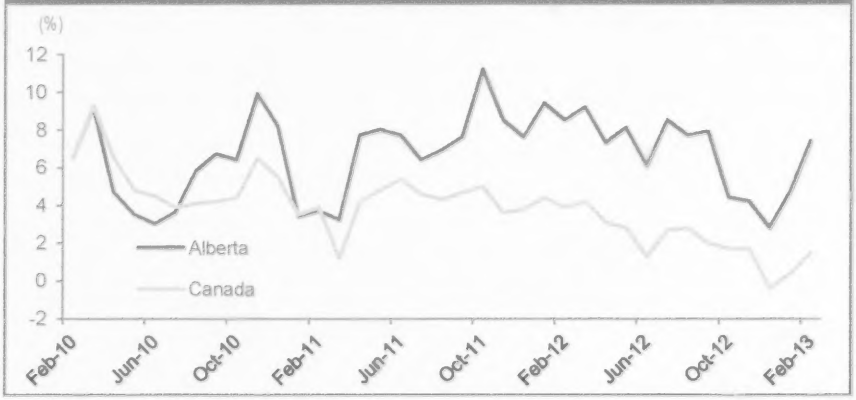
Alberta's inflation rate remains low by historic standards, but has been trending up over the last few months. Consumer price inflation came in at 1.2% in March, its highest reading since September, driven by increases in shelter costs and a smaller drop in electricity prices. Average weekly earnings (AWE) growth continues to outpace inflation. AWE rose by $16 in February, the largest one-month increase since last summer, and was up by 4.6% over the same month last year.

Chart 2: New Housing Price Index (2007=100)



Source: Statistics Canada

Chart 3: Retail sales growth (year-over-year)



Source: Statistics Canada

Servicing Household Debt
A Provincial Perspective

Rising household debt in Canada is an often cited risk to the Canadian economy. This InFocus utilizes a relatively new data set by Statistics Canada to show how debt service ratios compare by province. We find that Alberta's debt servicing costs, as a share of income, have fallen over the last five years and are slightly below the national average.

Why is there so much focus on household debt?

Canadian household debt continues to rise as a share of income (Chart 1). In contrast, US households have been deleveraging since 2008. As outlined by the Bank of Canada and others, this poses a risk to the Canadian economy, as measures to reduce household debt would put downward pressure on consumption and housing activity. The federal government has acted to curtail rising debt by imposing stricter regulations on borrowers and mortgages, while the Bank of Canada has indicated that it is willing to use monetary policy to address household imbalances.

How is the debt situation unfolding?

A gradual deleveraging by households is the most desired outcome. To date, this appears to be the path of adjustment. The accumulation of Canadian household debt is growing at a slower rate and some real estate markets (e.g. Vancouver and Toronto) are now correcting. The Bank of Canada, in its April Monetary Policy Report, says that "the adjustment in the housing sector is intended and welcome." Further, while some debt measures remain elevated, such as the debt-to-income ratio, others remain healthy. In particular, overall debt servicing costs as a share of income have been falling in Canada, supported by record low interest rates.

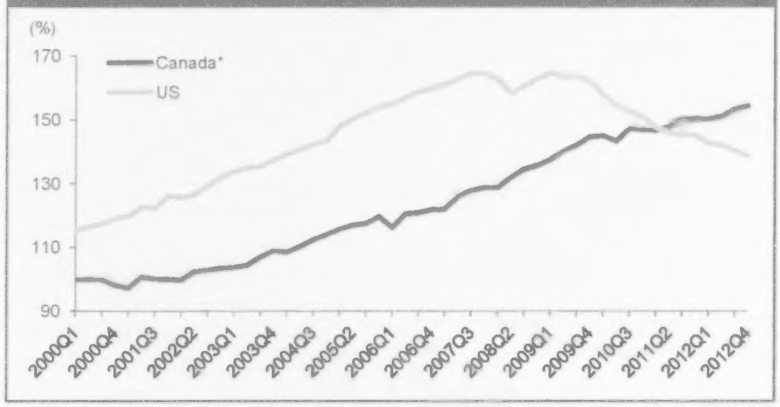
Debt servicing costs as a share of income

Statistics Canada's new household accounts provide some insight on provincial household debt burdens. While Statistics Canada does not currently track the stock of debt by province, it now has an indicator called the "debt service ratio" (DSR) which is the interest households pay on debt per year divided by household disposable income (after-tax income). This ratio is valuable for determining the affordability of debt for a given year.

How does Alberta compare?

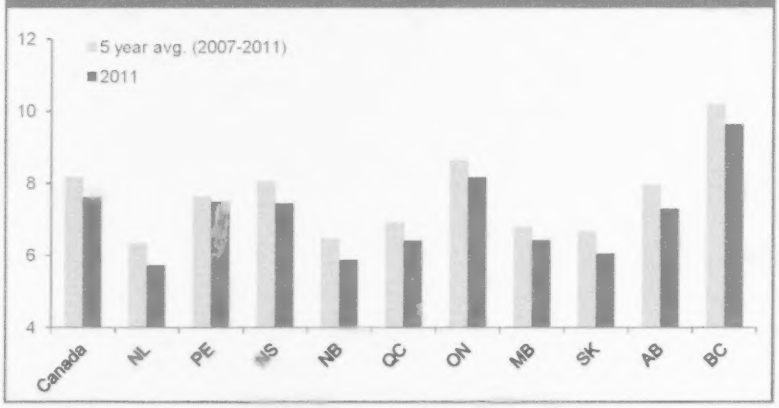
Alberta's DSR has been at or below the national DSR for the five years the ratio has been measured. In 2011, the latest year available, Alberta had a DSR of 7.3, which was slightly below the national ratio of 7.6. These two ratios have fallen every year since 2007, driven by falling interest rates and rising incomes. Alberta held the fifth

Chart 1: Household debt-to-disposable income



Source: Statistics Canada, Federal Reserve, BEA
* As per Statistcs Canada, Canadian data are modified to be consistent with US Data

Chart 2: Household debt service ratio (DSR) by province*



Source: Statistics Canada
* Interest payments on household debt as a share of after-tax household income.

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highest DSR in 2011. In comparison, British Columbia holds the highest DSR at 9.6, followed by Ontario (8.2), while Newfoundland and Labrador has the lowest DSR (5.7).

Alberta's mortgage and consumer DSR slightly below national average

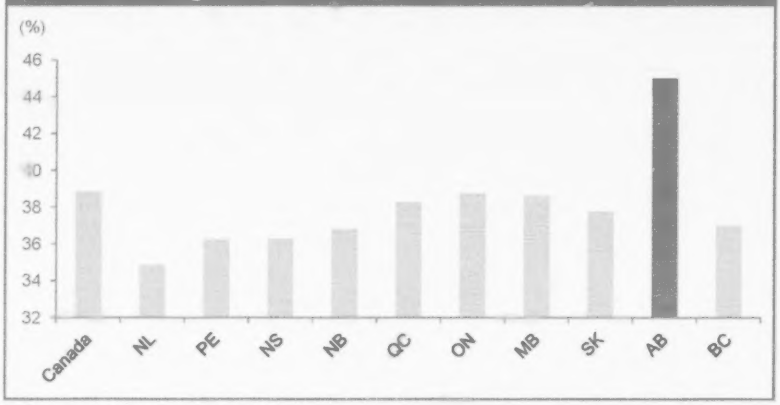
Alberta's DSR is driven lower by the consumer debt component, which includes non-mortgage debt such as credit cards, auto loans, and lines of credit. In 2011, Alberta's consumer DSR (3.6) was slightly below the national average ratio (3.8).

Alberta's mortgage DSR was slightly higher than the national average from 2007 to 2010; however, in 2011 the mortgage DSR edged below the national average.

High incomes support debt payments

On average, Albertans can afford to service more debt than other provinces due to higher incomes. In 2011, household disposable income was 31.4% greater than the national average and highest among all provinces. In addition to lowering the DSR, high incomes have contributed to relatively affordable housing in Alberta. According to RBC Economics, Edmonton and Calgary have the two most affordable housing markets of the major city centers in Canada (see chart 3). RBC calculates "housing affordability" by measuring what percent of income is required to pay for housing costs (mortgage payments, property taxes and utilities).

Chart 4: Percent of primary household maintainers under the age of 45



Source: Statistics Canada, 2006 Census

Demographic factors

According to recent research at the Bank of Canada, younger people typically hold more debt relative to their income than older age groups. Debt allows younger households to attain higher consumption than their income would otherwise allow, which helps many of them buy a house or raise a family. The life-cycle hypothesis suggests that households are better off smoothing consumption across their lifetimes, which may require holding higher debt in a household's early years then paying it off in the later years.

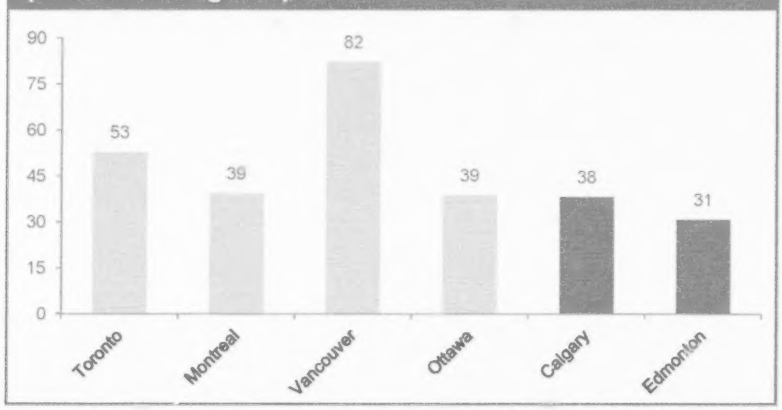
Alberta households are the youngest among the provinces. According to the 2006 census, the percentage of primary household maintainers under the age of 45 in Alberta was the highest among the provinces at 45.0% and significantly above the national average of 38.8% (see chart 4). Alberta's young population is likely putting upward pressure on its DSR.

Conclusion

The debt service ratio (DSR) of Canadian households has fallen over the last five years, reflecting a sharp decline in interest rates and rising incomes. In Alberta, the DSR has also declined, and currently sits slightly below the national average despite having a relatively young population.

Comparing DSRs has its limitations. In particular, it only shows the ability of households to service debt at current interest rates and income levels. Increasing interest rates or an adverse shock to incomes poses risk to both Canadian and Albertan households' ability to service debt.

Chart 3: RBC housing affordability index, February 2013 (detached bungalow)



Source: RBC Economics

Rate of consumer bankruptcies lower in Alberta

Another measure of the ability of households to service their debts is consumer bankruptcies. In Alberta, consumer bankruptcies are falling at one of the fastest rates in the country, dropping 18.1% in 2012 (behind only Saskatchewan). The large decrease has pushed down the province's bankruptcy rate. In 2012, only 1.9 people per 1,000 over the age of 15 declared bankruptcy in Alberta, well below the national rate of 2.5.

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